Cultural Capital

A fundamental driver of financial performance

By Richard Barrett

Abstract

This paper explores the topic of cultural capital and its relationship to financial performance. It reviews research on this topic and comes to the conclusion that even though there is no direct measure of cultural capital, proxy measures such as cultural alignment and cultural entropy clearly indicate a positive correlation between cultural capital and sustained high revenue growth.

Do you see your organisation's culture as a significant part of your business' performance equation? Do you see it as a driver of your financial performance? If your answer is not a resounding "Yes," then you may want to read on.

What is culture?

The most universally accepted definition of culture is "the way things are done around here." Effectively, what this means is that culture is a way of being. It is a reflection of the conscious and subconscious values, beliefs and behaviours of a group or collective entity, such as an organisation, that determine the "personality" of the group. Culture is who you are, and what you stand for.

Culture is determined by the values, beliefs and behaviours of the current leaders of an organisation and the institutional legacy of past leaders as reflected in the values and beliefs that underpin the policies, systems, processes, structures and procedures of the organisation.

What is cultural capital?

Cultural capital is a measure of the value that can be placed on the way of being or "personality" of a group, collective entity, or an organisation. The difference in performance of a strong, adaptable culture compared to a weak, rigid culture is a reflection of the level of cultural capital in the two organisations. Although there is no precise measure of cultural capital, cultural entropy (the degree of dysfunction) can be used as a proxy for measuring cultural capital--high cultural entropy is synonymous with low cultural capital, and low cultural entropy is synonymous with high cultural capital.

Culture and performance

Whether you recognise it or not, your organisational culture is an important factor of your performance. Therefore, monitoring and measuring your culture is vitally important to your organisation's success. During the past 150 years we have seen a significant shift in how organisations leverage their competitive advantage.

In the Agricultural Age, organisations focused on manpower. The more manpower you could muster, the more land you could till, and the more income you could make delivering your crops to the market place. In the Industrial Age, productivity and quality became the principal arenas of competitive advantage. Companies worked on improving their margins and delivering the quality that customers were seeking. In the Information Age, the focus shifted to intellectual capital, and organisations competed for the best and brightest. We moved into a knowledge economy. Now, as we move into the Cultural Age, not only are organisations having to focus on quality, productivity, and talent management, they are recognising that who they are and what they stand for—their vision and values—are significant differentiators in attracting and keeping talented people and fostering high levels of staff engagement. In other words, cultural capital has become the new frontier of competitive advantage.

As we passed through these different ages, organisations developed methods for measuring and managing their competitive advantage by focusing on the most important drivers of performance. They focused on measuring because whenever you attempt to measure something, what you measure tends to improve. Consequently, during the Industrial Age, organisations measured productivity and quality. During the Information Age, they attempted to measure intellectual capital. And, now during the Cultural Age, they are attempting to measure cultural capital.

Until the creation of the Barrett Values Centre's Cultural Transformation Tools, cultural capital was difficult to measure. The Cultural Transformation Tools and the Barrett Model provide a breakthrough technology for measuring and managing organisational cultures, and more importantly, a way of managing performance by measuring cultural entropy.

Research findings

The link between culture and performance has been investigated and proven by a number of researchers. In 2001, Eric Flamholtz from the University of California at Los Angeles[1] conducted a study to explore the affect corporate culture has on the bottom line. As part of his research, Flamholtz discovered a strong positive correlation between cultural agreement (a proxy for values or cultural alignment) and the company's EBIT (Earnings Before Interest and Taxes). Some of the results from this study are shown in following diagram.

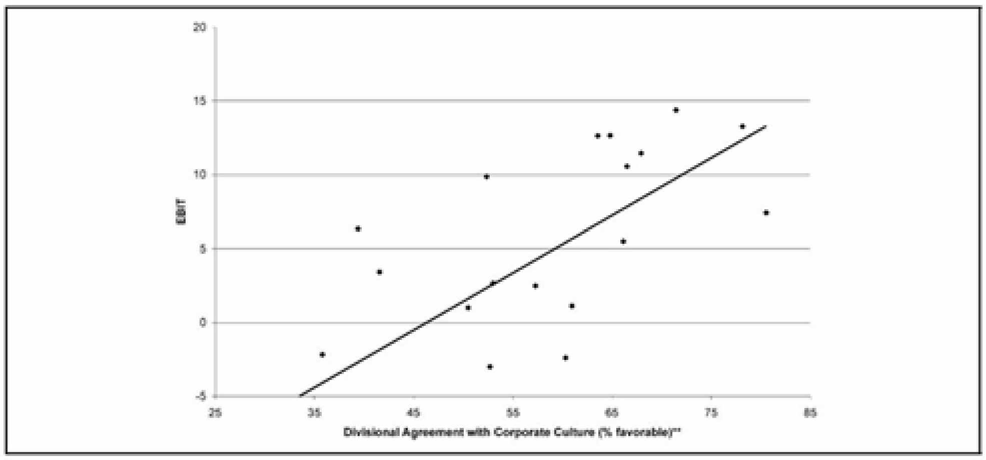

Figure 1: Cultural alignment and the bottom line

Flamholtz concludes, "Organizational culture does have an impact on financial performance. It provides additional evidence of the significant role of corporate culture not only in overall organizational effectiveness, but also in the so-called "bottom line.""

Performance of the best companies to work for in the USA

More recently, the Barrett Values Centre researched the financial performance of the top twenty publicly traded Best Companies to Work For in the USA in 2008, by evaluating the growth in their share price over the previous ten years.

[1] Flamholtz, Eric. "Corporate Culture and the Bottom Line." *European Management Journal* Vol. 19, No. 3 (2001): 268-275.

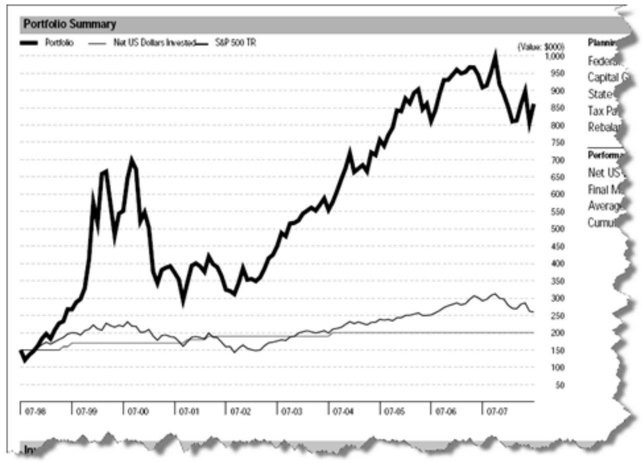

Figure 2: Growth in share price of the top twenty publicly traded best companies to work for in the USA, 1997 to 2007

The results showed that investing in the top twenty companies realised an average annualised return of 16.74%, compared to 2.83% for the S&P 500. This strong financial performance underlines the importance of the employee experience in contributing to the success of a company.

The Best Employers surveys

Hewitt Associates have been using their employee engagement survey as part of their Best Employers Survey for more than a decade. They have found that the Best Employer organisations, be they in the private or public sector, are always "best in class" in terms of performance. Here are some of the key characteristics of Best Employers:

1. Best Employers attract and retain employees, resulting in significantly lower levels of employee turnover—40% lower in Asia, 45% lower in Australia, 54% lower in Canada, 30% lower in Europe and 50% lower in USA. Best Employers have nearly double the number of applications per position than other organisations. Scott McNealy of Sun Microsystems estimates that being a Best Employer is worth $75 million annually to his company in recruiting, retention, and productivity gains.

2. Best Employers have faster revenue growth. Among the data collected in the Best Employer surveys is each company's financial information for the last three years. Using these numbers, it has consistently been found that the Best Employers exceed the rest in revenue growth, year after year. For example, in 2003, the Best Employers attained 17.3% revenue growth compared to 10.73% for the rest.

3. Best Employers have higher levels of productivity. Revenue per employee is consistently higher in the Best Employers. Breaking down the revenue per full-time

employee shows that companies considered the Best are able to achieve higher levels of employee productivity.

Performance of best employers in Australia and New Zealand (BEANZ)

A study of 163 organisations, carried out by Hewitt Associates and Barrett Values Centre as part of the 2008 Best Employer study in Australia/New Zealand, showed that:

> *Cultural alignment and cultural entropy significantly influence employee engagement, and employee engagement significantly influences organisational and financial performance.*

The findings of this study confirmed that the degree to which employees are aligned with the values of the current culture has a significant impact on financial performance. The study found a strong correlation (0.8) between cultural entropy and employee engagement (See Figure 3).

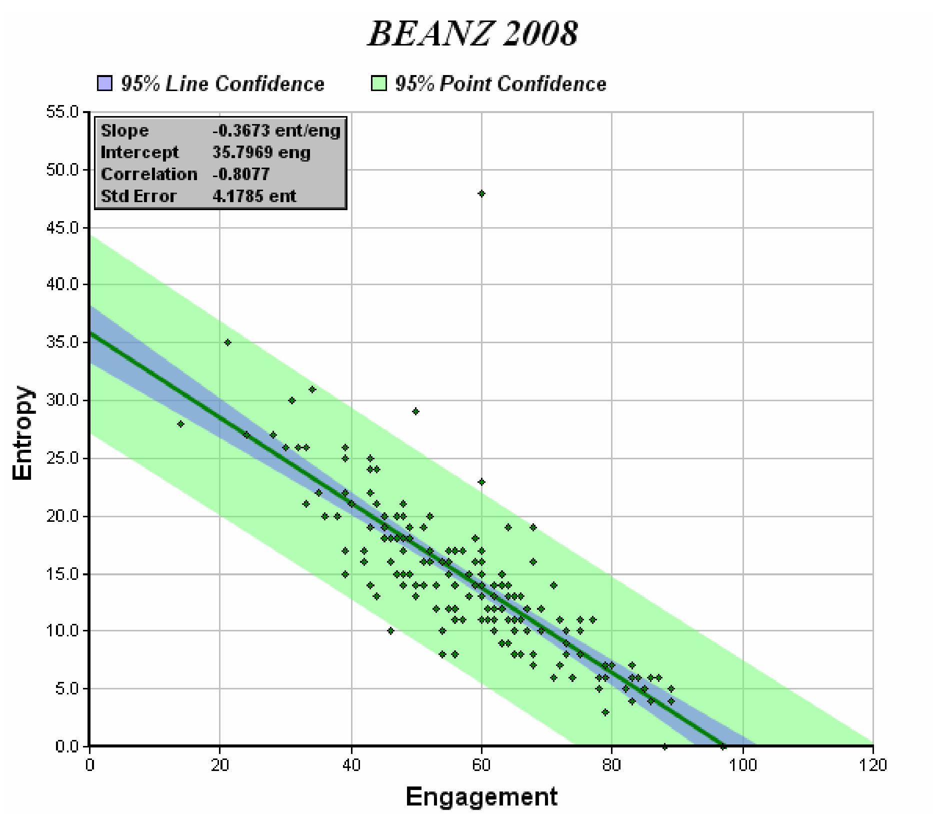

Figure 3: Correlation between cultural entropy and employee engagement for 163 organisations in Australia and New Zealand

The values that were present in the best employers in Australia and New Zealand, and not in the worst, were all values that reflected a positive employee experience—employee recognition, teamwork, coaching/mentoring, and balance (home/work).

Organisations with low cultural entropy (below 10%) and with high employee engagement (above 65%) had 35% revenue growth over three years compared to only 7% for organisations with high cultural entropy (above 20%) and low employee engagement (below 65 %).

Conclusion

Using employee engagement and cultural entropy as proxy measures for cultural alignment (cultural capital), we can categorically state that organisations with high levels of cultural alignment will have superior levels of financial performance.

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